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Employee Share Schemes Commission on Taxation Recommendations

The Commission on Taxation Report, published 7 September 2009, sets out the Commission's recommended changes to the Irish tax system. Proposals cover all tax heads and include changes which would have implications for employers and employees. This Bulletin summarises the proposals which have implications for companies operating employee share incentive arrangements.

Approved Profit Sharing Schemes

The Report proposes that existing tax reliefs for Revenue approved profit sharing schemes (APSS) should be retained. Such broad based employee share schemes allow companies to distribute 'profits' in the form of shares to employees on a tax free basis. APSS can be used in conjunction with an objective performance related bonus plan and are widely used by subsidiaries of multinational companies operating in Ireland and leading Irish public companies.

Currently, employees can be allocated shares up to an annual value of €12,700 tax free. In addition, there is no employer's PRSI cost and the benefits received are also outside the charge to the income and health levies. Consequently, the APSS has proved very attractive to both employers and employees.

However, while it is proposed to retain the tax exemption, the Report recommends imposing a charge to PRSI and the levies. For companies already operating an APSS this would mean the current employer's PRSI saving may be eroded such that the immediate cost savings will lie solely with the participants going forward.

Save As You Earn Schemes

The Report proposes that the existing tax reliefs for Revenue approved save as you earn (SAYE) schemes should be retained. Such broad based employee share schemes allow companies to grant employees options over company shares which attract favourable tax treatment.

Currently, employers can grant options at a discount of up to 25% and participants have no tax to pay unless and until the shares are sold. At that point the lower capital gains tax (CGT) rate applies and only on gains in excess of the annual CGT exemption. In addition, there is no employer's PRSI cost and the gain is outside the charge to the income and health levies. Given the current economic challenges, many organisations have recently been looking at SAYE as a means of offering incentives to staff, particularly where bonus payments have had to be deferred.

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While it is proposed to retain the tax exemption for SAYE, the Report also recommends imposing a charge to PRSI and the levies, presumably at the point of exercise of the option. One of the attractions of SAYE has been that, in general terms, there is no direct cost to the company and the employee funds the exercise price through a linked savings mechanism. However, the potential introduction of an employer's PRSI charge may now need to be factored into the ultimate cost to companies, both in relation to subsisting options and any future grants.

Employee Share Purchase Plans

The Report proposes that the existing tax reliefs for SAYE, as outlined above, should be extended to other broad based employee shares plans, such as US style employee share purchase plans (ESPP).

Currently employees participating in an ESPP would save for a six month period and have the facility to acquire shares at a discount of up to 15%. Where share prices are rising these plans have the ability to offer very generous incentives for staff. Under existing tax rules, the discount is fully liable for income tax and the levies, but not liable for PRSI.

However, while the extension of favourable 'SAYE' type tax treatment to ESPP would be a welcome development, similar to other share schemes, it is now proposed to impose a charge to PRSI. This would have the effect of increasing an employer's costs by 10.75% of the aggregate discount offered to employees.

Approved Share Option Schemes

The Report proposes that the existing tax reliefs for Revenue approved share option schemes (ASOS) should be discontinued. Since 2001, ASOS have allowed companies to grant employees options over company shares, which attract favourable tax treatment.

Currently, employees can be granted market value options and there is no tax to pay unless and until the shares are sold. At that point the lower CGT rate applies to the gain accrued, along with the annual CGT exemption. In addition, there is no employer's PRSI cost and the gain is outside the charge to the levies.

The proposal to discontinue the tax incentive largely reflects that the current restrictions applicable to such schemes are prohibitive and unworkable for most organisations. Indeed there has been very little take-up of such schemes since 2001.

Unapproved Share Options and Share Awards

The Report does not propose any change to the tax treatment of other unapproved employee share schemes. Therefore, the existing tax treatment for share options, share awards and restricted share schemes will likely continue as before.

However, the Report does propose that all forms of employee share schemes would be liable to PRSI. This would be a change from the existing position and would have the effect of imposing significantly increased employer PRSI costs in relation to the value of any shares allocated to employees.

The Report is silent as regards an effective date for the proposals or

whether the changes would apply to shares already granted but not yet vested. While companies will have made a provision in their accounts in relation to any subsisting share awards, the imposition of a PRSI charge, at 10.75%, would require immediate consideration by companies so as to ensure that unexpected liabilities are minimised in the medium and longer term.

Employee Share Ownership Trusts

The Report does not propose any change to the tax treatment of employee share ownership trusts (ESOTs). This would be good news for former semi-state organisations, given that ESOTs have largely been confined to transformation arrangements within those organisations.

However, ESOTs are generally operated in conjunction with an APSS, as the delivery vehicle, and it seems that there is also an intention to impose a PRSI charge in relation to the value of shares allocated to employees through the ESOT/APSS. This could be a significant issue for those organisations who have yet to allocate shares currently held in an ESOT.

Relief for New Shares Purchased by Employees

The Report proposes that the current tax relief available to employees, who acquire newly issued shares in their employing company, is to be discontinued.

Under current tax rules a tax deduction of up to €6,350 is available in relation to the cost of acquiring new shares. The relief is subject to a variety of conditions and can be clawed back in certain circumstances. The combination of the various restrictions attaching to this relief has meant that it has not been widely used in recent years.

Other Measures to Note

The Commission is recommending that stamp duty on all share transactions should be reduced to zero, which would be a very welcome development. In addition, the Commission is of the view that capital gains should not be taxed to the extent that they arise from inflation. This could see the reintroduction of indexation relief for capital gains, or some form of tapering relief depending on how long the shares are held.

Summary and Conclusions

The proposal to bring all share awards within the charge to PRSI would be significant if adopted, in that it would introduce a new cost for employers who are already struggling to reduce employment costs.

The proposal to extend PRSI to tax favoured share schemes seems a retrograde step. Such schemes are by definition broad based and operate on similar terms. They also fulfil the Government's stated intention of promoting greater employee share ownership. The logic of affording a tax favoured mechanism on the one hand, only to impose a charge to PRSI and the levies on the other, is unclear. It also runs counter to other reliefs which apply to tax and PRSI, so that there is symmetry as between the two.

If the proposal is to go ahead, it would seem reasonable that it would only apply to future share awards and not to any subsisting awards which have yet to vest. This is particularly relevant given that such costs would not have been envisaged when awards were originally made. Indeed, the IFRS2 accounting position would also need to be considered now in catering for the impact these proposals might have.

Furthermore, it may be that any Irish model would be introduced in a similar fashion to the UK, where it is possible for the employer social security costs to be passed on to the ultimate beneficiary, the employee.

The Report acknowledges that there are likely to be significant administrative issues associated with the implementation of this recommendation. It would be important that these issues are adequately addressed in a timely manner so that employers are not overburdened with further cumbersome payroll changes.

To the extent that companies may be considering making share awards to employees over the coming year, there may be some merit in considering whether it is appropriate to accelerate such awards. This may possibly avoid any increased PRSI costs in the short term. Clearly, the overall business objectives need to take precedence, but opportunities for cost savings should not be overlooked.

At the very least, it would appear that the potential risk of additional cost to employers for share awards could now make such schemes less attractive when compared to certain share plans where the cost to the company can be more tightly controlled. This is particularly the case in a rising market where share price increases might be more common than in the past eighteen months. As such, the concept of share award schemes or indeed share options schemes with caps on the maximum benefit available could well be sensible considerations for organisations looking to manage costs and to ensure they reward sustainable performance. There are a number of possibilities in this area which companies can consider immediately.

It should be noted that the Commission's proposals have no statutory effect and merely reflect their recommendations. These proposals will be considered by Government in the run up to the Budget in December. If your organisation has any specific concerns in relation to the proposals, we would be interested in hearing your perspective.